

Proposed Amendments to SEBI (Infrastructure Investment Trusts) Regulations, 2014 and the SEBI (Real Estate Investment Trusts) Regulations, 2014

1. Objective

1.1. This Board Memorandum proposes amendments to the SEBI (Infrastructure Investment Trusts) Regulations, 2014 (hereinafter referred to as "InvIT Regulations") and SEBI (Real Estate Investment Trusts) Regulations, 2014 (hereinafter referred to as "REIT Regulations") and seeks approval of the Board for the same.

2. Background

2.1. SEBI notified InvIT and REIT Regulations on September 26, 2014. Government of India in the budget of 2014-15 introduced a separate chapter on InvITs and REITs defining them together as "Business Trusts". Further, various tax related exemptions/clarifications have been provided to "Business Trusts", in the budget of 2014-15, 2015-16 and 2016-17.

2.2. Till date, 3 InvITs have issued and listed their units raising approximately Rs. 10,000 crores and 1 REIT is in the process of making a public offer.

3. Market Representation and consultation process

3.1. SEBI received representations from the industry and market participants for making certain amendments to InvIT and REIT Regulations.

3.2. Based on these representations, experience gained from existing InvITs and interactions with market participants, a consultation paper, dated January 25, 2019, proposing amendments to the REIT and InvIT Regulations was floated for public consultation, wherein comments were sought till February 18, 2019 (Consultation Paper placed on SEBI website for public comments is enclosed at **Annexure-I**). The proposals presented in the consultation paper are following:

3.2.1. Reduction in the minimum allotment and trading lot for publicly issued InvITs and REITs;

3.2.2. Increase in the leverage limit for InvITs;

3.2.3. New regulatory structure for privately placed unlisted InvITs.

3.3. The aforesaid amendments, proposed in the consultation paper, are aimed at providing flexibility in fund raising and improving access of these investment vehicles to investors.

3.4. Comments received on the consultation paper, as referred above, have been collated and suitably incorporated in the present memorandum.

4. Proposal to the Board:

In light of the comments received on the proposals in the consultation paper, the amendments proposed in the InvIT and REIT Regulations, along with the rationale, are as under:

A. Amendments proposed to both REIT and InvIT Regulations

4.1. Reduction in the minimum allotment and trading lot

4.1.1. Current regulatory requirement:

i. InvIT

Regulation 14(4)(c) of the InvIT Regulations prescribes that the minimum subscription in an initial offer and a follow-on offer from an investor shall be Rs. 10 lakhs. Further, Regulation 16(9)(b) of the InvIT Regulations prescribes that the trading lot for the purposes of trading of publicly issued and listed units of an InvIT, on the designated stock exchange, shall be Rs. 5 lakhs.

ii. REIT

Regulation 14(14) of the REIT Regulations provides that in the case of issue of units by a REIT, the minimum subscription from any investor in an initial offer

as well as in a follow-on offer shall not be less than Rs. 2 lakhs. Further, as per Regulation 16(4) of the REIT regulations, the trading lot for the purpose of trading of units of the REIT, on the designated stock exchange, shall be Rs. 1 lakh.

4.1.2. Need for Review:

- i. InvITs and REITs are categorized as stable, income yielding vehicles as regulations, inter alia, provide for investment mainly in completed and revenue generating assets and distribution of 90% of the distributable cash flows to the unit holders. These vehicles generally provide relatively better risk-adjusted returns vis-a-vis other comparable investments. It is, therefore, desirable that a wider class of investors, including retail investors, have access to InvITs and REITs, which could be facilitated by bringing down the minimum allotment and trading lot in these investment vehicles. Incidentally, internationally REITs are vehicles for providing investment opportunity for retail investors. This, in turn, may also help in imparting sufficient liquidity to units of InvITs and REITs.
- ii. The investor protection norms, built in the regulatory framework for InvITs and REITs, provide protection to investors similar to those for listed companies. Further, while the units are listed and traded on exchanges, the limits placed for minimum allotment and trading lot are different from the current requirements for investment in equity shares of a listed company (minimum allotment lot for a company going for initial issuance of equity shares is between Rs 10,000 to Rs 15,000; also, even a single share of such a company can be traded on exchanges). Accordingly, the demand from market participants to sufficiently reduce the allotment and trading lot for InvITs and REITs so as to bring it in alignment with that for equity shares.
- iii. This aspect was also discussed in the SEBI's Working Group on REITs and InvITs, which agreed in favour of reducing the size of minimum subscription and trading lot.

- iv. A total of 20 comments have been received on the proposal with 13 agreeing and 4 disagreeing with the proposals, rest are mainly in the nature of suggestions. It is also to be noted that major international jurisdictions including USA, UK, Singapore, Hong Kong, France, Germany, Japan, Australia etc. place no restrictions on minimum trading lot/ticket size for REITs, Yield Cos (similar to InvIT).

4.1.3. Changes proposed:

- i. Considering the above, it is proposed that the minimum application and trading lot for publicly issued InvITs and REITs be revised as under:
 - a. At the time of initial/follow-on issue, the minimum application and allotment lot shall be of 1 lot consisting of 100 units.
 - b. Allotment shall be made only in multiples of a lot, such that the value of a lot is not below Rs. 15,000.
 - c. After initial listing, a trading lot shall also be of 100 units.
- ii. Further, for existing InvITs/REITs, whose units are publicly issued and are listed, it is proposed that the revised trading lot shall be as determined by the Stock Exchange(s), in terms of proposal at para (4.1.3)(i)(a) and (4.1.3)(i)(b) above. Further, the stock exchanges shall undertake the same within a period of 6 months from the date of notification of these regulations.

B. Amendments proposed in InvIT Regulations

4.2. Increase in the leverage limit

4.2.1. Current regulatory requirement:

- i. Regulation 20(2) of the InvIT Regulations provides that the aggregate consolidated borrowings and deferred payments of the InvIT, holdco and the SPV(s), net of cash and cash equivalents, shall never exceed 49 % of the value of the InvIT assets. Further, as per Regulation 22(4)(b) of the InvIT

Regulations, any borrowing exceeding 25% of the value of the InvIT assets requires unit holders' approval and mandatory credit rating.

4.2.2. **Need for Review:**

- i. It has been represented by various stakeholders, that the extant cap of 49% on the borrowings of an InvIT restricts its operational flexibility and may adversely impact the profitability of InvITs. The arguments put forth in favor of the representation are:

- a. Inability to offer returns as compared to other alternative investment avenues:

Most of the operating infrastructure projects in the country are generally leveraged between 70% to 80% of the value of the assets. InvITs consist largely of operating infrastructure assets, which provide stable long-term cash flows, and have the capacity to bear a significantly higher leverage than the currently prescribed limit, without adversely impacting the risk profile of the InvIT.

Thus, the current limitation on leverage restricts InvITs from offering returns comparable to other alternative investment avenues with similar assets.

- b. Restricting the availment of additional capital for funding acquisition:

One of the core value propositions for investing in InvITs, in addition to offering stable yield, is its capacity to acquire new assets.

InvITs are by law required to distribute at least 90% of their distributable cash flows to the unitholders. Thus, to acquire any new asset, an InvIT needs to raise funds either by way of equity capital or debt. The extant limit on the consolidated debt (49% of the value of InvIT assets), places restriction on the InvITs' ability to acquire new assets for growth.

- c. International Experience:

International jurisdictions such as Yield Cos. in the U.S.A. and investment funds in the UK also place no such restrictions on the leverage these vehicles can undertake.

- ii. It was provided in the consultation paper that InvITs, which have a track record of distribution of at least 3 years, be permitted to increase their borrowings beyond 49%. It is felt that InvITs with proven track record of distributions would have the necessary capacity to service higher levels of debt. However, prescribing track record of distribution in terms of number of years may not be a true reflection of an InvIT's capacity to service additional debt as there could be InvITs making multiple distributions in a year. Accordingly, it may be more appropriate if the capacity of an InvIT to service additional debt is quantified in terms of number of distributions rather than in terms of number of years. Given the regulatory requirement of at least two distributions in a year, it is proposed that InvITs that meet the requirement of at least 6 distributions on a continuous basis may be considered to be eligible to enhance their borrowings beyond 49 %.
- iii. The aspect of relaxing the limit on leverage for InvITs was also discussed in the SEBI's Working Group on REITs and InvITs and the group also recommended increasing the leverage limits for InvITs subject to certain conditions. A total of 23 comments have been received with 18 of them in favour of the proposal, 3 against and rest are in the nature of suggestions.

4.2.3. Changes proposed:

- a. Taking into account the above arguments, it is proposed that the leverage limit for InvITs be increased from existing 49% to 70%. However, any InvIT which proposes to raise its consolidated borrowings beyond 49% shall have to comply with the following:
 - 1) The consolidated debt of InvIT and the project debt, shall have a credit rating of AAA or equivalent from a rating agency registered with the Board;

- 2) InvIT shall have a minimum track record of 6 distributions on a continuous basis, post listing, in the years just preceding to the Financial Year in which the enhanced borrowings are proposed to be made;
- 3) InvIT shall seek approval of 75% of the unitholders (excluding related parties to the transaction) for increase in leverage;
- 4) The funds raised through debt, under the enhanced debt limit from 49% to 70%, shall be available specifically for acquisition/development of infrastructure assets.
- 5) In addition, they need to undertake the following:
 - a. Disclose financial results on a quarterly basis;
 - b. Undertake valuation of underlying assets on a quarterly basis;
 - c. Disclose following additional line items:
 - Asset cover available
 - debt-equity ratio
 - debt service coverage ratio
 - interest service coverage ratio
 - net worth

4.3. New regulatory structure for privately placed unlisted InvITs

4.3.1. Current regulatory requirement:

- i. InvIT Regulations, inter-alia, provide the framework for issuance of units of InvITs either through public issue or on private placement basis, where such units of InvITs are required to be listed on a recognised stock exchange.

- ii. Regulation 14(2)(d) and 16(7)(a) of InvIT Regulations require that the minimum number of investors in a privately placed InvIT shall be atleast 5, where any investor shall not hold more than 25% of the units of the InvIT. Further, Regulation 14(2)(c) mandates that the minimum investment in a privately placed InvIT shall be Rs 1 crore, however, if the InvIT holds more than 80% in completed and revenue generating assets, the minimum investment shall be Rs 25 crore.
- iii. Regulation 20(2) restricts the maximum leverage an InvIT can undertake, at 49 % of the value of the InvIT assets. Also, Regulation 16(8)(a) mandates that the units of a privately placed InvIT shall be mandatorily listed on the designated stock exchange(s).

4.3.2. **Need for Review:**

- i. Infrastructure as a sector is very important for the sustained growth of our country and the needs for investment in this sector are huge. InvIT as a structure was established with an aim of channelling private capital in infrastructure sector. It therefore becomes imperative that sufficient flexibility be provided to InvITs so that the ever increasing demands for investment in infrastructure sector are suitably met through this route. In this regard, representations have been received from various market participants, seeking relaxations from some of the requirements, as have been currently specified for privately placed InvITs.
- ii. It has been represented that investors in privately placed InvITs are usually large and sophisticated entities, who understand the risks and complexities of investing in such structures and are, therefore, comfortable in assuming risks associated with making large investments. Further, the investment requirements, for such investors, require flexibility in structuring the offering, so as to suit their risk and return expectations.
- iii. It has also been represented that for large institutional investors such as pension and provident funds, mutual funds, insurance companies, multilateral institutions etc., which are major investors in such privately placed InvITs, the maximum limit of 25% investment poses a challenge in making significant participation in the

InvIT. Such investors would like to participate more meaningfully in the InvIT by investing in larger amounts and consequently holding higher percentage in InvITs.

- iv. It has, therefore, been requested that following changes be made to the private placement framework under InvIT Regulations:
 - a. Increasing the limit on investment by a single investor;
 - b. Relaxing the requirement of minimum number of investors;
 - c. Allowing higher level of leverage;
 - d. Relaxing the requirement of asset mix in terms of completed and under construction assets;
 - e. Removal of mandatory listing requirement.
- v. A total of 18 comments were received on the proposal with 11 of them in favour and 3 against the proposal to create a new framework, others have suggested further modifications to the proposal.

4.3.3. **Changes proposed:**

- i. It is proposed to create a separate framework for privately placed InvITs, which provide sufficient flexibility to both issuers and investors but whose units are not permitted to be listed on recognised stock exchanges. The proposed framework shall have the following features:
 - a. The minimum number of investors in such an InvIT shall be as determined by the issuer including the maximum holding of units by a single investor;
 - b. Leverage shall be as determined by the issuer after consultation with investor(s);
 - c. The underlying assets can be completed, under construction or both;
 - d. The minimum investment by an investor shall not be less than Rs 1 crore;

- ii. The extant regulatory framework as applicable for privately placed listed InvITs shall be made applicable to privately placed unlisted InvITs, subject to the features detailed in para 4.3.3(i) above.
- iii. Existing privately placed listed InvITs may choose to migrate to the proposed framework for private unlisted InvITs, if they obtain the approval of more than 90% of their unitholders by value and exit may be provided to dissenting unitholders. Consequently, the units of such privately placed InvIT shall get delisted from stock exchanges.
- iv. Conversely a privately placed unlisted InvIT, may choose to list its units on stock exchanges, after complying with the requirements as applicable for a privately placed and listed InvIT.

5. Proposal to the Board

5.1. The Board is requested to consider and approve the proposals, as referred at paragraph no. 4 above. On approval of the proposals, the amendments to the SEBI (InvIT) Regulations, 2014 and SEBI (REIT) Regulations, 2014, shall be placed before the Board for its approval.

(The Board Memorandum must be read in conjunction with the press release issued on March 01, 2019 and minutes of the meeting.)

(Consultation paper available on SEBI website)